TESTIMONY BEFORE THE

HEALTH SUBCOMMITTEE

OF THE

HOUSE ENERGY AND COMMERCE COMMITTEE

ON

PLANNING FOR LONG TERM CARE

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Mr. Chairman and members of the Subcommittee, I am Dr. Byron Thames, a physician and a member of AARP's Board of Directors. Thank you for the opportunity to testify today. Remaining independent in later years is a priority for AARP members. Yet, if you ask the average person about retirement planning, one of the most critical components is often overlooked – how to finance future long-term care needs.

Most of us don't want to think that we will ever need long-term care, but the reality is that as our population continues to age we will increasingly rely on long-term care services to remain independent. Therefore, we need to do a better job of educating consumers about the likelihood for needing long-term care, the cost, options, and the importance of planning prior to a crisis.

We must also ensure that there are a range of long-term care options from which to choose. Based on recent reports, sales of private long-term care insurance policies have slowed and Long-Term Care Partnership programs in the original four states have sold relatively few policies. Reverse mortgages have high costs and are more expensive than home equity loans.

Americans also need a better means of financing long-term services and supports. Current financing options are often too expensive and too complex. In some cases, they are also tied to institutional care rather than a system that gives consumers what they want, such as self-directed care with cash payments to purchase services.

We commend the Subcommittee for taking the first step by holding this hearing. We urge members to look for positive ways to encourage and enable more persons to plan for long-term care.

Our testimony today will focus on the need for broader education efforts and three financing options -- long-term care insurance, the Long-Term Care Partnership Program, and reverse mortgages -- and improvements that should be made to each to enhance their ability to be viable financing options for Americans.

Consumer Education: A Critical and Ongoing Step

The first big challenge to planning for long-term care is public education. It is difficult to get many people to prepare for something so far in the future. Yet the goal should be that we think of long-term care as a critical part of retirement planning. We all should understand the likelihood of needing long-term services and supports at some time in the future; the types, costs, and availability of such services and supports; the options available to help plan and pay for such services; why it is in our interest to plan; and where we can go for further information and assistance about how to plan. The recently enacted Long-Term Care Information Clearinghouse will be a new resource to help Americans plan for long-term care.

AARP is working to educate our members about long-term care. For example, our publications include articles on topics such as long-term care insurance, reverse mortgages, long-term care costs, assisted living, nursing homes, and innovative ways to receive services at home. We also use other tools to educate our members such as AARP's consumer guide to reverse mortgages, Home Made Money, and tip sheets on topics ranging from hiring a home care worker to purchasing long-term care insurance to choosing an assisted living facility.

There are several obstacles that must be overcome in order for significant numbers of Americans to plan for long-term care. First, from what we've heard from our members, there is a great deal of resistance to thinking about long-term care. For example, persons associate long-term care with nursing homes and/or insurance, and they believe that talking about the issue signifies sickness and/or a loss of personal control or independence. Our members do not want to become a burden to their families. They also want to have choice, and for the vast majority of individuals, this choice is staying in their homes.

It is also not unusual to find individuals under the mistaken impression that Medicare covers long-term care, so they believe that further long-term care planning is unnecessary. Since individuals frequently have negative perceptions or misimpressions about long-term care, they are often discouraged from seeking out information, and in denial about their likely need for future services. As a result, they will often wait until a crisis to act.

On top of this, there are day-to-day realities that families across this country face. Most families are focused on immediate needs -- making mortgage payments, saving for their children's college education, and paying for rapidly increasing health care costs. Many in the sandwich generation are saving for their children's college education while also helping to pay for their parents' long-term care needs. That's all before individuals save for their own retirement. Under these circumstances, planning and saving for long-term care often falls to the bottom of the priority list.

When the day-to-day financial demands on many Americans are coupled with the negative perceptions about long-term care, there are significant challenges to engaging individuals in planning for their futures. That is why it is important that long-term care be considered as a part of overall retirement planning.

Current Options are Limited: Americans Need More Financing Options

Even once individuals get past their day-to-day demands and begin to look into planning for long-term care, they discover that their options to pay for long-term care are quite limited. There is no comprehensive public system of long-term care available to most Americans and very few other long-term care financing options exist. Long-term care insurance is limited and generally expensive. According to America's Health Insurance Plans, in 2002, the average cost of a long-term care insurance policy with automatic inflation protection was $1,134 per year when purchased at age 50 and $2,346 per year if purchased at age 65.

The Long-Term Care Partnership Program allows individuals who buy long-term care insurance policies under the program to protect a certain amount of their assets and become eligible for Medicaid if they meet all of Medicaid's other eligibility criteria. The expansion of this program may provide a new option for some Americans to finance their long-term care, but public education is critical around this option and additional improvements should be made to the program.

Public programs are also limited. Medicare covers some home health and skilled care, but does not cover nursing home stays. Medicaid – while a critical safety net for those with no other options – has income and asset limits that require impoverishment.

For individuals who pay out-of-pocket for care, they often find that costs associated with years of care outstrip personal savings. The average annual nursing home costs were over $64,000 for a semi-private room and over $74,000 for a private room in 2005. The average hourly rate for a home health aide in 2005 was $19, so as little as 10 hours a week of home health care would average close to $10,000 a year.

Many Americans rely on informal caregivers, such as family and friends, for the bulk of long-term care services. According to an analysis of data from the National Long-Term Care Survey for AARP, over 90 percent of persons age 65 and older with disabilities who receive help with daily activities are helped by unpaid informal

caregivers. Two-thirds of those 65 years of age and older with disabilities who receive help with daily activities only receive informal unpaid help, up from 57 percent in 1994. But caregivers face many physical, emotional, and financial demands that often take a serious toll. If caregivers do not take care of themselves or get the support that they need, they may no longer be able to care for their loved ones and may need someone to care for them.

AARP believes that Americans need more options to plan and pay for their care. Due to the limited options available today, Medicaid has become the default payer of long-term care. One of the reasons that we strongly opposed the Medicaid changes in the Deficit Reduction Act was that the legislation took a punitive approach without providing alternative long-term care financing options for individuals. We hope this hearing will be part of ongoing work in Congress to give Americans incentives and positive options to plan and pay for future long term services and supports that they may need.

Long-Term Care Insurance

Relatively few older persons have private insurance that covers the significant cost of long-term care. Many common long-term care needs (e.g. bathing, dressing, and household chores) are not medical in nature, do not require highly skilled help and therefore, are not generally covered by private health insurance policies or Medicare.

The market for private long-term care insurance has grown in recent years, but its overall role is still limited. Long-term care insurance pays for only about 9 percent of all long-term care costs. By the end of 2002, over 9.1 million long-term care insurance policies had been sold in the United States, with about 6.4 million of these policies still remaining in force. Most policies sold today cover services in nursing homes, assisted living facilities, and in the home. Typically, policies reimburse the insured for long-term care expenses up to a fixed amount, such as $100 or $150 per day. To receive benefits, the insured must meet the policy's disability criteria. Nearly all policies define disability as either severe cognitive impairment or the need for help in performing at least two activities of daily living (such as bathing and dressing). Most policies sold are in the individual market.

The cost of long-term care policies varies dramatically depending on a number of factors: the consumer's age at the time of purchase, the amount of coverage, and other policy features. Insurance companies can increase premiums for entire classes of individuals, such as all policyholders age 75 and older, based on their claims experience in paying benefits. Older adults are more likely to have more long-term care needs and higher costs, thus higher premiums. Other factors that affect the policy's premium include the duration of benefits, the length of any waiting period before benefits are paid, the stringency of benefit triggers, whether policyholders can retain a partial benefit if they let their policy lapse for any reason, (including inability to pay -- nonforfeiture benefit), and whether the policy's benefits are adjusted for inflation. Individuals with federally qualified long-term care insurance policies can deduct their premiums from their taxes, up to a maximum

limit, provided that the taxpayer itemizes deductions and has medical costs in excess of 7.5 percent of adjusted gross income.

Many of the reasons already outlined that cause individuals to not plan for long-term care also are reasons that individuals have not bought long-term care insurance policies -- denial, believing Medicare pays for long-term care, and cost. Some individuals are wary of long-term care insurance due to large premium increases and market instability, for example when insurance carriers decide to leave the market. Further, some individuals are not able to qualify for long-term care insurance due to underwriting. For them and others, long-term care insurance is not a viable option.

Consumer protections are a critical part of long-term care insurance policies. Standards and protections for long-term care insurance policies could make them better products that consumers are more likely to buy. For example, an individual who buys a policy in his or her 60s may not need long-term care for over 20 years. Without inflation protection, the value of the insurance benefits can erode over time. A daily benefit of $100 in coverage will not buy as much care in 2025 as it does today. Nonforfeiture protection allows a consumer who has paid premiums for a policy, but can no longer afford to pay premiums, to still receive some benefits from the policy. Another important protection is premium stability to help protect consumers whose premiums increase above a certain threshold. Long-term premium affordability is an important reason why persons may drop long-term care policies or not buy policies in the first place.

The National Association of Insurance Commissioners (NAIC) has developed a Long-Term Care Insurance Model Act and Regulations that states can adopt to provide standards for long-term care insurance policies sold in a state. NAIC standards include: inflation protection, nonforfeiture, required disclosures to consumers, minimum standards for home health and community care benefits, premium rate stabilization, and standards for what triggers benefits. While all states have adopted some of the NAIC provisions, only about 21 states have adopted a critical provision on premium stability that protects consumers from unreasonable rate increases that could make their policies unaffordable.

Legislation (H.R. 2682) introduced by Representatives Nancy Johnson (R-CT) and Earl Pomeroy (D-ND) updates consumer protections mandated by the Health Insurance Portability and Accountability Act of 1996 and incorporates some of the consumer protections in the NAIC Model Act and Regulations. AARP supports the standards for long-term care insurance included in this legislation.

Education is also critical for individuals to decide whether or not to purchase a long-term care policy, and if so, which policy best suits their needs. To make an informed decision, consumers need to understand many things, including: the terms that are used in policies, what the benefits are and when they start, what is not covered, what the consumer pays, and how they can compare one policy to another. Different policies may use different definitions and make it hard for consumers to make an apples-to-apples comparison of long-term care policies.

Consumers who are considering purchasing long-term care insurance need better tools to help them compare different policies to find which one is best for them.

Finally, there has been some discussion of establishing a mandatory long-term care insurance program. AARP urges caution about moving in this direction. As cited above, long-term care insurance is not affordable to many Americans without some kind of subsidy. Further, long-term care insurance is not available to many individuals with pre-existing conditions. Therefore, insurance market reforms would be necessary.

Long-Term Care Partnerships

Prior to the enactment of the Deficit Reduction Act, the Long-Term Care Partnership Program was only operating in California, Connecticut, Indiana, and New York. The Deficit Reduction Act (DRA) allows all states the option to enact partnership policies. The new partnership programs do include some important consumer protections. Long-term care insurance policies in these new programs must meet specific criteria including federal tax qualification, specific provisions of the 2000 NAIC Model Act and Regulations, and inflation protection provisions. Compound annual inflation protections will be required for purchasers below age 61 (states can determine the level of protection, such as 3 percent or 5 percent). Some level of inflation protection will be required for purchasers between the ages of 61 and 75. The DRA also requires the development of a reciprocity agreement by the Department of Health and Human Services to enable purchasers to use

their benefits in other partnership states; however, states may opt out of this reciprocity.

The expansion of the partnership program could mean that a significant number of individuals will have a new financing option available to them. However, consumer education is absolutely critical. In order to make an informed decision about whether or not to purchase a partnership policy, it is important for individuals to understand that Medicaid eligibility is not automatic. Even though a partnership policy allows purchasers to protect a certain level of assets if they deplete their insurance benefits, individuals must first meet the state's income and functional eligibility criteria in order to quality for Medicaid. These criteria may change by the time individuals apply for Medicaid. If individuals do not meet these criteria, they will not be eligible for Medicaid.

If a long-term care policy's functional eligibility criteria are different than a state Medicaid program's functional eligibility criteria, individuals may have a gap in coverage after they use up their long-term care policy and before they qualify for Medicaid.

In addition, once individuals qualify for Medicaid after depleting their insurance benefits, there is no entitlement to home-and community-based services. Thus, individuals may not be able to receive the home-and community-based services that they were receiving under their policy under Medicaid.

As the federal government and states implement the partnership program, they should include strong consumer education, so that consumers understand what they get and what they do not get with a partnership policy. There should be clear disclosure of current income requirements for Medicaid benefits and the state's right to change those requirements. Guaranteeing the types of services (particularly home-and community-based services) that the state would provide to eligible partnership policyholders under Medicaid would be a good improvement in the program. States and the federal government should consider adding additional consumer protection standards, such as premium stability, to partnership policies. Strengthening the reciprocity agreement would also benefit consumers and give them peace of mind if they anticipate moving in the future to another state that does not participate in the reciprocity agreement. Further, states should monitor nursing home admissions to ensure that equal access is available to everyone on the waiting list, regardless of source of payments.

Over time, it will be important to evaluate the results of the partnership program to determine its impact on individuals and the Medicaid program. According to a Government Accountability Office review of the program, in the four original partnership states, about 172,500 policies are in force and about 1,200 individuals are receiving partnership benefits. Since the program began, about 250 policyholders in all four states have exhausted their long-term care insurance benefits, and of those, about 120 have accessed Medicaid. It is unclear whether these persons using Medicaid would have likely spent down to Medicaid absent their participation in the program. It is not clear whether the policies were

purchased by people who otherwise would not have bought insurance, whether the partnership policies are a substitute for other long-term care insurance policies, and whether participants would have used Medicaid regardless. Because partnership policyholders tend to be younger than other long-term care policyholders, it may be hard to assess the full impact of the partnership program on Medicaid for now. It is possible that not enough time has passed for many partnership policyholders to have exhausted their long-term care insurance policies and become eligible for Medicaid.

Reverse Mortgages

Because of the large and growing amount of home equity held by some older Americans, increased attention is being paid to the role that home equity could play in financing long term care. Over the past decade, more homeowners have begun using their home equity as a means of paying for long-term care services. In some cases, they have done so by selling their homes and using the proceeds to pay for services in assisted living and continuing care retirement communities (CCRCs). Others have used home equity to retrofit their houses or to pay directly for home and community-based services.

One of the tools increasingly used by people who want to tap into their home equity is a reverse mortgage, which is a loan against a home that requires no repayment until the borrower dies, sells the home, or permanently moves out of the home. There are two basic types of these mortgages: public sector reverse

mortgages that must be used for a single purpose, and private sector reverse mortgages that can be used for any purpose. Public programs are offered by some state and local governments, generally at a low cost, and with income requirements. Most of these programs are limited to paying for home repairs or property taxes, although Connecticut developed a program specifically for long-term care financing.

Private sector reverse mortgages can be used for any purpose and have no income requirements. They are offered by private lenders and have high costs. They include the Home Equity Conversion Mortgage Program (HECM) that is insured by the Federal Housing Administration (FHA) of the Department of Housing and Urban Development (HUD), as well as two smaller private programs. Federally insured HECMs make up about 90 percent of the private sector reverse mortgage market.

To qualify for a HECM, an individual must: be age 62 or over; occupy the home as a primary residence; have paid off the mortgage or have a mortgage balance that could be paid off with proceeds from the reverse mortgage at closing; undergo required counseling; and live in a home that meets minimum HUD property standards. According to a HUD study, HECM borrowers tend to be older, female, from a variety of racial and ethnic groups, live alone, and have lower incomes.

The amount of money available from a private sector reverse mortgage depends upon: the age of the youngest borrower; the value of the home; the median home

value in the county; current interest rates and other loan costs; and the type of private sector loan. Money from the reverse mortgage can be paid to the borrower as a lump sum payment at closing, monthly payments, a line of credit, or a combination of these methods. Borrowers make no loan payments as long as they live in the house – an advantage for an older person who wants to remain at home rather than enter a nursing home. The loans are paid back when the last living borrower dies, sells the house, or permanently moves away.

Despite their advantages, reverse mortgages are not suited for everyone. The high costs associated with the loans are a real disadvantage – particularly to a lower income person with a modest amount of home equity. The private reverse mortgage market is relatively new, and although still growing, consumers do not yet have tremendous choice. And current private sector reverse mortgages are not available to anyone under the age of 62, which excludes their use as a source of long-term care financing for younger persons with disabilities.

Using Reverse Mortgages as a Long-Term Care Financing Tool

Reverse mortgages could be an option for some individuals to pay for long-term services and supports, such as home health care, chore services, respite care, and home modification. Home-and community-based services help enable an individual to live at home, where most older adults want to be. As the Subcommittee examines reverse mortgages, it is important to note in what ways

they would be useful as a long-term care financing tool and in what ways they would not be helpful.

High Costs of Reverse Mortgages are a Barrier to their Use

The high costs of reverse mortgages are a significant barrier to their use, including as a long-term care financing option. During the past year, the average value of a home in the HECM program was about $255,000. The fees and other non-interest costs of a HECM on such a home in many urban areas can be over $25,000 over the life of the loan. The upfront costs would include $5,100 for the initial mortgage insurance premium, up to another $5,100 for the lender's origination fee, and about $2,200 in third-party closing costs. The average borrower in the program is a 74-year-old single female. If she lives to her remaining life expectancy (until age 86) and uses only half of her initial loan amount, she could also owe about $5,000 in monthly servicing fees and about $8,000 in periodic mortgage insurance premiums.

So the total cost of the loan -- excluding interest -- could be about $25,400 over the life of the loan, which is greater than the average annual income of HECM borrowers. Most Americans would be highly reluctant to take out a loan in which the fees alone exceed their annual incomes. But many older homeowners are faced with exactly this dilemma -- an attractive loan that meets their needs and is insured by the federal government -- but costs significantly more than they believe is reasonable or are willing to pay.

The substantial costs faced by an individual who chooses to use her home equity for long-term care can be illustrated in the following examples. A 75-year-old HECM borrower in a $150,000 home who uses her HECM to pay for $3,000 a month in home care would pay a 53.2 percent total annual percentage rate if her loan were to end after one year. Because of the higher origination fees and mortgage insurance premiums, the same borrower in a $250,000 home would accrue costs at an effective rate of 72.3 percent at the end of the first year even though she borrowed the same amount of money for home care. (See attached appendix for a more detailed analysis of the costs associated with reverse mortgages.)

While the effective rates on HECMs go down over time, homeowners with disabilities are more likely to borrow for shorter periods with higher effective costs. Moreover, the usage patterns that borrowers are likely to follow if they are using HECMs for long-term care are not reflected in current disclosure requirements. As a result, required disclosures are likely to significantly understate the effective short-term costs for borrowers who need money to pay for monthly service costs.

Reverse Mortgages and Long-Term Care Insurance – Critique of Existing Provision

In 2000, Congress included a provision in the American Homeownership and Economic Opportunity Act that waives the upfront mortgage insurance premium

for individuals who get a reverse mortgage through HECM if all the available equity is used to buy long-term care insurance. Consumer organizations – including AARP – have objected to the required tie to an insurance purchase and, to date, HUD has not implemented the program.

Tying the purchase of long-term care insurance to a reverse mortgage is expensive for the consumer and not necessarily the best way to finance needed services for a number of reasons. The homeowner pays all the costs associated with the reverse mortgage plus the premiums and cost-sharing associated with the long-term care insurance policy. Current disclosure requirements do not adequately ensure that consumers are fully informed of the total, combined cost of the loan and the insurance policy. Over time, reverse mortgage costs can double or triple the total cost of purchasing long-term care insurance due to high upfront loan costs and the growing amount of interest charged on the loan. (See attached appendix for examples of the costs associated with purchasing long-term care insurance with a reverse mortgage.)

Another concern with tying a reverse mortgages to the purchase of long-term care insurance is the lack of a requirement to disclose the risks related to long-term care insurance policy cancellation or lapses. If an individual exhausts all available reverse mortgage funds for the long-term care insurance premiums and is no longer able to pay the premiums, the policy could be cancelled or lapse due to nonpayment. The insurance coverage would be lost; the borrower would owe

substantial and growing debt on the home; and would no longer be able to pay for the cost of long-term care.

Finally, borrowers could only use the loan money to pay for insurance policies and not to directly purchase home-and community-based services or for home modifications that may better meet their needs. Most older Americans want to remain in their homes and receive needed services there rather than be institutionalized. Use of reverse mortgages may be one means of financing long-term care, but consumers should not be required to use their equity to purchase an insurance policy. Rather, they should have the choice to use the equity for the appropriate services in their homes. We are urging Congress and the industry to look for ways to reduce the high costs of reverse mortgages for all homeowners, and especially for older homeowners with disabilities, to enable them to remain independent in their homes.

A More Promising Approach

As the Subcommittee examines reverse mortgages, we believe that several principles are important to guide the consideration of reverse mortgages as a long-term care financing option:

- Reverse mortgages should be a voluntary option and not a requirement.
- The high costs of reverse mortgages should be reduced, especially for those with long-term care needs.

- Reverse mortgages should have strong consumer protections, including required counseling and protections against those who might take advantage of reverse mortgage borrowers.
- Consumers should be informed of the range of available long-term care financing options and their pros and cons (including costs), as well as the potential financial impact on a spouse, so that consumers can make an informed decision about the best option for them.

We encourage the Subcommittee to examine ways to reduce the costs of reverse mortgages for individuals with long-term care needs. The high costs of reverse mortgages are the greatest barrier to their use for long-term care. Specifically, we encourage consideration of a public-private approach to reducing reverse mortgage costs for individuals with long-term care needs. Congress could consider pursuing such an approach in place of the incentives to use reverse mortgages to purchase long-term care insurance that were included in the 2000 housing legislation.

One approach might be to provide lower cost reverse mortgages to individuals with long-term care needs through a competitive demonstration program in selected states. Such a demonstration might be done as part of the HECM program, and states would compete to participate based on their willingness to take steps to lower the costs to consumers. States could choose to originate and service these lower cost HECMs and/or provide other subsidies and services to qualified homeowners. HUD could have the flexibility to reduce some of the loan

costs for eligible borrowers, especially the up front mortgage insurance premium. Lenders and services could compete to participate in the program based on fees charged to consumers. Such a program could be tried on a smaller scale and should include an evaluation of its effectiveness in reducing reverse mortgages costs, the use of reverse mortgages as a long-term care financing option, which segments of the population might be best served by using reverse mortgages to pay for long-term care, how reverse mortgages could help expand access to home-and community-based services, and how to give people more choice and control in how they receive long-term care services.

Borrowers would be able to access their own home equity to pay for the lower-cost services they want that are tailored to meet their needs instead of waiting for estate recovery and liens to reimburse Medicaid for the institutional care they want to avoid. Borrowers would also not be as limited in their choice of providers or services as they would be under Medicaid.

The public sector has experimented with reverse mortgages relating to long-term care. The HECM program also provides valuable experience that could be drawn on to establish such a program to allow older homeowners with long-term care needs to remain in their homes longer by using reverse mortgages to pay for services that they need to remain independent. Such a program would create opportunities for the federal and state governments, the private sector, and consumer groups to work together to explore the potential of reverse mortgages to pay for long-term care.

Conclusion

Just as Americans need to plan for long-term care, Congress must look for options that would allow Americans to pay for the care they need in the setting of their choice. We urge you to move beyond all the long-term care jargon and acronyms to focus on the individuals and families, such as the husband and wife who have lived in their home most of their lives and want to stay there, but need services and supports to help them remain at home or the widow who is suddenly on her own and needs help after caring for her husband for years.

AARP looks forward to working with this Subcommittee, Congress, the Administration, and all stakeholders to help Americans plan for their future long-term care needs and give them more tools to do so. We stand ready to work with members on both sides of the aisle to begin to tackle this important challenge.

Appendix

Analyzing the Cost of Home Equity Conversion Mortgages (HECMs)

The non-interest costs of a HECM loan for a borrower of average age (74) living in a home of average value ($255,000) can be about $25,000, assuming the borrower lives to the remaining life expectancy (12 years) prescribed by federal Truth-in-Lending disclosures for HECM loans. Table 1 itemizes the fees, all of which are charged to the loan at closing except for the monthly servicing fee and monthly mortgage insurance premium.

Table 1: Total HECM Fees until Life Expectancy for a 74-year-old Borrower in a $255,000 Home*

Loan Fee	HUD Limit or Specification	Amount
Origination Fee	Limited to 2% of home value or HUD's county equity limit, whichever is less	$5,100
Upfront Mortgage Insurance Premium (MIP)	Equals 2% of home value or HUD's county equity limit, whichever is less	$5,100
Third-Party Closing Costs	Limited to "customary & reasonable"	$2,200**
Monthly Servicing Fees	Limited to $35 per month	$5,040***
Monthly MIP	Equals 0.04167% of loan balance each month	$8,014***
	TOTAL FEES =	**$25,454**

Source: AARP calculations based on:

* The average HECM borrower in FY 2005 was 73.8 years old and lived in a home worth $254,900.
** Hypothetical national average; actual figures range from less than $2,000 to more than $6,000.
*** Assuming borrower lives to the remaining median life expectancy (12 years) for a 74-year-old and withdraws 50% of the available loan amount at closing, which is the credit line usage pattern prescribed by Truth-in-Lending law for HECM disclosures. In this loan, the amount withdrawn from the HECM credit line at closing is $71,115, which is 50% of the available credit line amount. The assumed interest rate is the one that was in effect on 5/10/06, which was 6.48%. For additional information see the Methodological Note on page 2.

Table 2 shows all the costs on the HECM loan from Table 1. The "Loan Fees" column shows that the fees of $25,454 from Table 1, when added to the loan balance, generate $20,552 in interest charges over the 12 years of the 74-year-old borrower's remaining life expectancy. The "Loan Advances" column shows that a credit line cash advance of $71,115 to the borrower at closing generates another $83,325 in interest charges. So at the end of the loan, the homeowner has borrowed $71,115, but now also owes $25,454 in loan fees plus $103,877 in total interest charges for a total cost of $129,331 – which is 182% of the loan amount ($71,115). The loan balance (amount owed) at this time is $200,446.

Table 2: Total HECM Fees, Interest, and Loan Advances until Life Expectancy for a 74-year-old Borrower in a $255,000 Home*

	Loan Fees	Loan Advances	TOTAL
Principal	$25,454	$71,115	$96,569
Interest	$20,552	$83,325	$103,877
TOTAL =	$46,006	$154,440	$200,446

* See table 1 for details about this loan.

Methodological Note: The total of ongoing costs actually paid on the loan presented in Tables 1-2 would differ from the amounts estimated for the following reasons:

- The tables assume that the initial interest rate never changes over the life of the loan. But the interest on HECM loans is adjustable. So if the actual rate decreases, then ongoing interest and mortgage insurance premium (MIP) costs would be less, and if the actual rate increases, then ongoing interest and MIP costs would be more.
- The tables assume that the loan ends when the borrower reaches her remaining median life expectancy. But some borrowers will remain in their homes longer than that, and others will leave or die sooner. The total costs for longer-lived borrowers would be greater than the estimated amounts, and the total costs for those who leave or die sooner would be less.
- The tables assume that creditline borrowers withdraw 50% of their available loan funds at closing and none thereafter, which is the withdrawal pattern prescribed for HECM disclosures by federal Truth-in-Lending law (as explained in the footnotes to Table 1). In reality, HUD research has found that creditline borrowers have withdrawn their available funds at a substantially earlier and greater rate. Since the amount of funds remaining available in a HECM creditline grows larger every month, this more aggressive actual withdrawal pattern would result in larger loan balances and, therefore, greater charges for interest and monthly mortgage insurance premiums.

The Cost of Purchasing Home Care & Long-Term Care Insurance Using a Home Equity Conversion Mortgage

The short-term cost of a federally-insured Home Equity Conversion Mortgage used to purchase home care is substantial. The table below shows the total annual average percentage rate on a HECM used to purchase home care at $3,000 per month for a 75-year-old borrower assuming three different initial home values.

Total Annual Percentage Rate of a HECM* Used by a 75-Year-Old Borrower to Purchase Home Care for $3,000 Per Month at Three Initial Home Values

At End of Year:	Total Annual Percentage Rate when Home Value =		
	$150,000	**$250,000**	**$550,000**
1	53.2%	72.3%	91.7%
2	19.4%	24.7%	30.3%
3	Funds Exhausted in 7th Month	15.4%	18.1%
4		12.0%	13.6%
5		Funds Exhausted in 8th Month	11.4%

*Source: AARP calculations based on an origination fee equaling 2% of home value or HUD limit ($362,790), whichever is less, monthly servicing fee of $35, interest as of 5/15/06 (6.48%), and typical third-party closing costs for each home value.

The cost of long term care insurance (LTCI) purchased with a HECM includes the cost of the LTCI policy plus the cost of the HECM, which includes upfront fees plus monthly servicing, interest, and mortgage insurance costs.

The table below assumes that a 62-year-old couple living in a $250,000 home is using a HECM to purchase a LTCI policy that costs $508 per month in May of 2006. It also assumes an interest rate of 6.48%, a monthly servicing fee of $35, an origination fee equaling 2% of the home value ($5,000), $2,201 in 3rd-party closing costs, and -- to simulate a provision in current law that forgives the upfront mortgage insurance premiums if all of the HECM proceeds are used to buy LTCI -- no upfront mortgage insurance premium.

The table demonstrates how the average total monthly cost of this loan would rise over time in 2-year increments. In particular, it shows how much the monthly cost of this HECM would add to the cost of the monthly LTCI premium being paid by this couple:

- Over the first two years, the loan adds 82 percent to the cost of LTCI.
- By the time the couple reaches age 70, the monthly cost of its HECM loan ($518) would exceed the cost of its monthly LTCI premium, adding 102 percent to the cost of the LTCI premium.
- At this couple's approximate life expectancy (age 82), the monthly loan cost ($1,714) would add 337 percent to the cost of the LTCI premium, for a total monthly cost of $2,222.

	Increases in Monthly Costs for Using a HECM to Buy LTCI (as outlined above under current law provision)			
In Years	**Monthly LTCI Cost***	**+ Monthly HECM Costs****	**= Combined Monthly Cost of LTCI and HECM**	**Monthly Cost Increase*****
1-2	$508	$418	$926	82%
3-4	$508	$361	$869	71%
5-6	$508	$419	$927	82%
7-8	$508	$518	$1,026	102%
9-10	$508	$645	$1,153	127%
11-12	$508	$798	$1,306	157%
13-14	$508	$978	$1,486	193%
15-16	$508	$1,189	$1,697	234%
17-18	$508	$1,432	$1,940	282%
19-20	$508	$1,714	$2,222	337%
21-22	$508	$2,038	$2,546	401%
23-24	$508	$2,412	$2,920	475%
25-26	$508	$2,843	$3,351	560%
27-28	$508	$3,338	$3,846	657%
29-30	$508	$3,908	$4,416	769%

Source: AARP calculation based on the following data:

* $508 is the monthly premium for the prepackaged "Comprehensive 150+" plan offered by the U. S. Office of Personnel Management through its Federal Long Term Care Insurance Program at www.opm.gov.

**Includes servicing, interest, and periodic mortgage insurance premium plus $7201 in upfront costs divided by number of months since closing.

*** Monthly HECM costs divided by monthly LTCI costs. These percentage increases would be less if LTCI premiums rise, but that would increase the total cost to the consumer.